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You Bargained for Confidential Arbitration but Your Adversary Sues in Public Court—Now What?

From secret formulas to priceless client lists, sensitive information is critical to the continued success of businesses large and small. In business dealings, trade secrets and competitive information are sometimes exchanged on a confidential basis. This is fine while all is well between the parties. Inevitably, however, sometimes disputes arise between commercial parties and maintaining the confidentiality of the information becomes an important consideration as the parties resolve their dispute.

The need to protect confidential information may influence the choice of forum for resolution of disputes. When a dispute is filed in a public court, it is presumed that materials filed on the docket will be available publicly. Thus, any public court proceeding presents a substantial risk that valuable trade secrets could be revealed in the course of prosecuting or defending claims. The standard for sealing records in courts is very high, and it is far from certain that a court will order that your valuable secrets will be kept confidential in litigation before the court. Choosing a public forum may, therefore, not be in your best interest when confidential information is at stake.

If an agreement between parties includes the exchange of trade secrets or sensitive commercial information, it is best practice to consider an arbitration provision for resolution of disputes. If upheld (as most are), the arbitration provision provides for the right to resolve disputes in a private (non-public) forum. Most arbitration authorities, such as the American Arbitration Association and JAMS, provide for certain levels of confidentiality by default. And it is common practice for arbitration agreements to also provide for maintaining confidentiality of the parties' arbitration proceedings.

But just because you bargain for confidential arbitration does not mean that your adversary will comply with its obligations. It is not uncommon for a nefarious counterparty to file a complaint in court even in the face of a binding arbitration provision. Most often, the recalcitrant adversary takes this course of action in the hopes of obtaining settlement leverage over you by way of the threat that your confidential information may be disclosed during the course of a public court proceeding. Sometimes, they hope that a public filing will draw attention from the press. Once your confidential information is disclosed in a public court, it is nearly impossible to make it confidential again. What are your options in this scenario?

Federal and nearly all state law provide parties the right to compel an adversary to submit their dispute to arbitration. In disputes subject to federal jurisdiction, the Federal Arbitration Act provides parties the right to petition the court for an order compelling the recalcitrant adversary to arbitrate. [1] State law generally provide for similar remedies. New York statutory law, for example, also provides for a right to petition a court to compel an adversary to arbitrate in compliance with an arbitration agreement. [2] Statutory law generally also provides that the court proceedings will be stayed while the arbitration proceeds.[3] Given the policy in favor of arbitration, courts will generally grant these applications to compel arbitration and stay court proceedings. Once compelled to arbitrate, your adversary is generally barred from filing any further documents with the court until the arbitration process is completed.

But this area of the law is rife with traps for the unwary. Your adversary may try to avoid arbitration by bringing the claim in the name of an affiliate or other person who did not sign the document containing the arbitration provision. Other times, a wily plaintiff may argue that you waived your right to arbitrate or that the arbitration agreement was superseded by a subsequent agreement. Thankfully, the law also provides remedies for these scenarios as well. Waiver arguments are disfavored by courts. And in the case of claims brought by non-signatories, several legal doctrines are available to require non-signatories to arbitrate as if they had signed the arbitration agreement itself. Many of these doctrines reflect common sense principles like agency and assumption. An agent acting on behalf of a principal who signed the arbitration agreement should be bound to arbitrate just like the principal. A successor who assumes the entire interest of its predecessor also should be bound to arbitrate. Another useful doctrine is the “direct benefits” estoppel doctrine, which holds that a party who knowingly accepts the direct benefits from a contract must also accept the obligations of that contract, including obligations under an arbitration provision.

Once an adversary has made a filing in a court, you may need to act promptly to request that any valuable trade secrets are sealed in that proceeding. Although the standard for sealing in judicial proceedings is high, it is almost always that case that the party who owns the trade secrets is best served by making an effort to protect the confidentiality of their information. In certain cases, a party may wish to proactively commence an action to compel arbitration. This way, the party seeking confidentiality can move on an expedited basis for a protective order restricting an adversary from filing confidential information.

Arbitration provisions serve an important purpose in modern business transactions. But enterprises involved in transactions touching on confidential trade secrets should keep in mind that they may not be able to rely solely on a contractual obligation to arbitrate to protect their trade secrets from disclosures. In some cases, the party seeking to protect confidential trade secrets may need to resort to action in a public court in

order to fully protect their trade secrets from disclosure even when an arbitration agreement applies. The important thing to remember is that you must take prompt action in order to protect the right to the confidential arbitration you bargained for in the first place.

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[1] 9 U.S.C. Section 4.

[2] N.Y. C.P.L.R. 7503(a).

[3] 9 U.S.C. Section 3; N.Y. C.P.L.R. 7503(b).